SUPREME COURT U. S.

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PETITION FOR WRIT OF CERTIORARI

In the Supreme Court of the United States

LEE J. ESPLIN, K. C. WEAVER, LEO REEVE, ARTHUR BARLOCKER and DOYLE SAMPSON,

Petitioners,

v.

LELAND (LEE) HIRSCHI and LA VERNE HIRSCHI,

Respondents.

Docket No. 1018

HARDIN A. WHITNEY, JR.
of the firm of
MOYLE & MOYLE

800 Deseret Building
Salt Lake City, Utah 84111

Attorney for Petitioners

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Come now Lee J. Esplin, K. C. Weaver, Leo Reeve, Arthur Barlocker and Doyle Sampson, herein referred to as "your petitioners" and petition this honorable Court for a Writ of Certiorari to the United States Court of Appeals for the Tenth Circuit. In support of this Petition and pursuant to Rule 23 of the Revised Rules of the Supreme Court of the United States, your petitioners show:

REPORTS OF OPINIONS DELIVERED IN THE COURTS BELOW

The United States District Court for the District of Utah was the court of original jurisdiction of this case. The suit was initiated as a class action under Rule 23, F. R. Civ. P., but the class action portion of the compiaint was dismissed before

the case came to trial. At the time he dismissed the class action portion of the plaintiff's complaint, the Trial Court judge rendered an opinion that is reported *sub. nom. Hirschi v. B & E. Securities, Inc.*, 41 F.R.D. 64 (D.C. Utah, 1966); the opinion is set forth in its entirety in Appendix "A" printed at the end of this Petition.

No report was made of the final decision in the case by the Trial Court. The case was appealed to the United States Court of Appeals for the Tenth Circuit. The opinion there is reported in 402 F. 2d 94 (10th Cir., 1968) and in CCH Securities Law Reports, ¶92,276; it is also set forth in its entirety in Appendix "B" printed following Appendix "A".

GROUNDS ON WHICH THE JURISDICTION OF THIS COURT IS INVOKED

The jurisdiction of this Court is invoked under the provisions of Title 28, U.S.C., §1254(1).

The decision of the Court of Appeals for the Tenth Circuit was entered September 30, 1968. It is this decision which your petitioners seek to review.

A Petition for Rehearing was timely filed October 19, 1968; it was denied November 6, 1968. The time for filing this Petition expires February 4, 1969.

QUESTIONS PRESENTED FOR REVIEW

While this case is one brought under the Securities Laws of the United States, the questions presented here for review transcend that field of the law and offer this Court an opportunity to pass upon two problems which have wide application in the civil courts today. One problem area is that concerned

with Rule 23, Federal Rules of Civil Procedure, and the determination of the Class Action device as an appropriate remedy or tool to use in the prosecution of Securities Acts and other cases. The other problem area deals with the rule of damages as historically applied by the Federal Courts, including the time and manner of measuring those damages. Specifically, the questions presented for review are:

1. The historical measure of damages applied by Federal Court in fraudulent misrepresentation cases has been the so-called "out-of-pocket" rule, which up to now has been, in the case of a sale, the difference between the price paid for property and its actual value at the time of the sale, its actual value being determined in the light of subsequent events or matters discovered subsequent to the date of the sale. *Smith v. Bolles,* 132 U.S. 125 (1889); *Sigafus v. Porter,* 179 U.S. 116 (1900); *Nashua Sav. Bank v. Burlington Electric Lighting Co.,* 100 F. 673 (CC Iowa, 1900); *Hindman v. First Nat. Bank,* (6th Cir., 1902) 112 F. 931, 57 L.R.A. 108, cert. den. 186 U.S. 483, 22 S. Ct. 943, 46 L. Ed. 1261; *Janigan v. Taylor,* 344 F. 2d 781 (1st Cir., 1965) cert. den. 382 U.S. 879, 86 S. Ct. 163 (1965); *Estate Counseling Service, Inc. v. Merrill, Lynch, Pierce, Fenner and Smith, Inc.,* 303 F. 2d 527 (10th Cir., 1962). Although the damage issue was submitted to the jury on this theory, the Trial Court measured the damages by the difference between the price paid for the property and its actual value *on the date plaintiffs discovered they had a cause of action,* as that date was found by the jury. This measure of damage was affirmed by the Court of Appeals. Thus the question presented for review is whether the historical measure of damages or the one adopted by the Trial Court should prevail.

2. In bringing this action as a class action, the plaintiffs' complaint alleged a number of activities in which the defend-

ants were supposed to have engaged which, it was alleged, were common to all members of the class. At the same time, the suit was filed after the apparent running of the appropriate statutes of limitation, which fact was also common to all members of the class. Many of the "issues" which might otherwise justify the maintenance of a class action were admitted. However, there were substantial issues which were not admitted, the resolution of which would depend upon factors peculiar to each member of the class. The Trial Court ruled that this case was not appropriate for class action treatment. (Appendix "A") The Court of Appeals reversed this holding. (Appendix "B") The specific question for review is whether the Court, in applying the criteria of Rule 23(b), F.R. Civ. P., to determine whether a given case is an appropriate one for class action treatment, should consider *all* "questions of law or fact common to the members of the class" as to whether they "predominate over any question affecting only individual members", or should the court consider only those questions which are in dispute and which will be the subject of the major battle between the parties. Here, for example, the statute of limitations had run unless a plaintiff had not known of the existence of his claim for more than a year after he had purchased his stock. Since the members of the class each had different opportunities to learn of the existence of any claim (most of the stock was sold to people who lived in a small town in southern Utah) a class action would require an examination into the subjective knowledge of each member of the class. There were also substantial questions concerning what each stockholder had relied upon in making his purchase. This problem has great significance in class action litigation and has not been passed upon before by this Court.

3. An issue properly includible in the second issue above described is whether the Court may require the action to pro-

ceed as an individual action as to those issues which are not appropriate for class action treatment under the authority of Rule 23 (c) (4) (A), F.R. Civ. P. Thus, the Court could require each member of the class to show that he is not barred by the Statute of Limitations; also, depending upon the appropriate date for measuring damages, what his damages were.

STATUTES AND REGULATIONS INVOLVED IN THE CASE

Section 10(b), Securities Exchange Act of 1934 (15 U.S.C.A. §78j, page 263)

> Sec. 10. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange—
>
> * * *
>
> (b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors.

Rule 10b-5, United States Securities and Exchange Commission, Rules, 17 C.F.R. §240.10b-5.

> Reg. §240.10b-5. It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails, or of any facility of any national securities exchange,
>
> (a) to employ any device, scheme, or artifice to defraud,
>
> (b) to make any untrue statement of a material fact or to omit to state a material fact necessary in or-

der to make the statements made, in the light of the circumstances under which they were made, not misleading, or

(c) to engage in any act, practice, or course of business which operates or would operate as a fraud or deceit upon any person,

in connection with the purchase or sale of any security.

Investment Company Act of 1940 (15 U.S.C. §§80a-1, et seq.) (The text of this Act is not reproduced because of its voluminous nature and its limited application to most of the contentions made in this petition.)

Rule 23, Federal Rules of Civil Procedure. 28 U.S.C.A., Rule 23, page 72 of 1969 Cumulative Annual Pocket Part.

Rule 23.

(a) *Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class,* (3) *the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.*

(b) *Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision* (a) *are satisfied, and in addition:*

(1) *the prosecution of separate actions by or against individual members of the class would create a risk of*

(*A*) *inconsistent or varying adjudications with respect to individual members of the class which would establish incompatible standards of conduct for the party opposing the class, or*

(*B*) *adjudications with respect to individual members of the class which would as a practical matter be dispositive of the interests of the other members not parties to the adjudications or sub-*

stantially impair or impede their ability to protect their interests; or

(2) the party opposing the class has acted or refused to act on grounds generally applicable to the class, thereby making appropriate final injunctive relief or corresponding declaratory relief with respect to the class as a whole; or

(3) the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action.

(c) Determination by Order Whether Action to be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be conditional, and may be altered or amended before the decision on the merits.

(2) In any class action maintained under subdivision (b) (3), the court shall direct to the members of the class the best notice practicable under the circumstances, including individual notice to all members who can be identified through reasonable effort. The notice shall advise each member that (A) the court will exclude him from the class if he so requests by a specified date; (B) the judgment, whether favorable or not, will include all members who do not request exclusion; and

(C) any member who does not request exclusion may, if he desires, enter an appearance through his counsel.

(3) The judgment in an action maintained as a class action under subdivision (b) (1) or (b) (2), whether or not favorable to the class, shall include and describe those whom the court finds to be members of the class. The judgment in an action maintained as a class action under subdivision (b) (3), whether or not favorable to the class, shall include and specify or describe those to whom the notice provided in subdivision (c) (2) was directed, and who have not requested exclusion, and whom the court finds to be members of the class.

(4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, or (B) a class may be divided into subclasses and each subclass treated as a class, and the provisions of this rule shall then be construed and applied accordingly.

(d) Orders in Conduct of Actions. In the conduct of actions to which this rule applies, the court may make appropriate orders: (1) determining the course of proceedings or prescribing measures to prevent undue repetition or complications in the presentation of evidence or argument; (2) requiring, for the protection of the members of the class or otherwise for the fair conduct of the action, that notice be given in such manner as the court may direct to some or all of the members of any step in the action, or of the proposed extent of the judgment, or of the opportunity of members to signify they consider the representation fair and adequate, to intervene and present claims or defenses, or otherwise to come into the action; (3) imposing conditions on the representative parties or on intervenors; (4) requiring that the pleadings be amended to eliminate thereform allegations as to representation of absent persons, and that the action proceed accordingly; (5) dealing with similar procedural matters. The orders may be combined with an order under Rule 16, and may be altered or amended as may be desirable from time to time.

(e) Dismissal or Compromise. A class action shall not be dismissed or compromised without the approval of the court, and notice of the proposed dismissal or compromise shall be given to all members of the class in such manner as the court directs.

STATEMENT OF THE CASE

In December, 1965, the plaintiffs-respondents (hereinafter referred to as "plaintiffs") brought suit against defendant B & E Securities, Inc. (herein "B & E") and others, including petitioners, claiming that the defendants were liable to them for 1) a violation of Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 promulgated thereunder and 2) a violation of the Investment Company Act of 1940. The suit was instituted as class action under Rule 23, F.R. Civ. P. Jurisdiction as to the first cause of action was invoked under Section 27, Securities Exchange Act of 1934 (15 U.S.C. § 87aa) and as to the second cause of action under Section 44, Investment Company Act of 1940 (15 U.S.C. § 80a-43).

On August 9, 1966, the Trial Court, in response to a motion of petitioners, dismissed the class action portion of plaintiffs' complaint. The opinion of the Trial Court dismissing the class action is reported *sub. nom. Hirschi v. B & E Securities, Inc.*, 41 F.R.D. 64 and is attached hereto as Appendix "A". Thereafter, the case proceeded to trial as a suit brought only by the individual plaintiffs.

On April 14, 1967, after trial, the jury returned its verdict by answering Special Interrogatories which, among other things, found the value of plaintiffs' stock on the date of the sale to them, on the date the suit commenced and at the date of the trial. After considerable oral argument by both sides, accompanied by a substantial number of written memorandums, the Trial Court awarded plaintiffs a judgment for $15,600.00 on their first cause of action and dismissed plaintiffs' second

cause of action as barred by the appropriate statutes of limitations.

The Trial Court dismissed the second cause of action as to your petitioners on the additional ground that they were not control persons. In determining the amount of the damages, the Trial Court found the value of plaintiffs' stock on a different date from any of the ones determined by the jury.

Your petitioners appealed from the Trial Court's determination of damages contending, *inter alia*, that the determination by the Trial Court was contrary to and in conflict with applicable decisions of the Supreme Court of the United States. The plaintiffs cross-appealed from the Trial Court's dismissal of the class action, contending that the facts were such as would lend themselves to a class action.

The decision of the Court of Appeals reversed the dismissal of the class action and affirmed the Trial Court's determination of damages, specifically affirming the judgment as to the named plaintiffs. Other than as to the named plaintiffs, the case was remanded to the District Court for proceedings consistent with the opinion.

The defendant B & E is a Utah corporation formed early in 1961 for the purpose of receiving and holding certain assets owned by the Bank of St. George which the bank examiners had directed the bank to dispose of. The incorporators and original directors of B & E were the defendants William A. Barlocker, Lee J. Esplin, K. C. Weaver, Leo Reeve and Arthur Barlocker. William A. Barlocker owned over 50% of the voting stock of B & E. The defendant Doyle J. Sampson was an employee and agent of B & E. The defendant W. B. Hail was an employee of B & E, but the claim against him was dismissed at the close of the plaintiffs' evidence and he is no longer involved (R. 1248).

Prior to the fall of 1961 the Board of Directors determined to sell stock in B & E to the public. Accordingly, the Articles of Incorporation were amended on August 7, 1961, to provide for 500,000 shares of common stock, 200,000 shares of Class A preferred stock, 300,000 shares of Class B preferred stock and 1,000,000 shares of Class C preferred stock (R. 613). All of the stock had a par value of $1.00 per share. Each class of preferred stock was entitled to a fixed yearly dividend of 5% per annum before any dividend was to be paid on the common stock. Dividends on the preferred stock were cumulative, and the preferred shares were also entitled to the payment of all accrued dividends upon liquidation before any distribution was to be made to the common shareholders (R. 614). Both Class A and Class B preferred stock was entitled to additional dividends out of earnings as the Board of Directors should determine (R. 614). Only the common stock was entitled to vote (R. 615).

Your petitioners had little voice in the control of B & E. The only voting stock of B & E was the common stock of which each petitioner owned the following amounts:

Petitioner	Common Shares Owned	Percent of Outstanding Common Stock Based on 165,000 Shares Outstanding	Record Reference
Lee J. Esplin	0	0	R. 110
Arthur J. Barlocker	853	0.52%	R. 108
Leo Reeve	497	0.30%	R. 113
Doyle Sampson	6,452	3.91%	R. 113
K. C. Weaver	987	.60%	R. 113
Total	8,789	5.33%	

Of the non-voting preferred stock, your petitioners owned (R. 109-119):

Petitioner	Class A Preferred	% of Total Outstanding	Class B Preferred	% of Total Outstanding
Lee J. Esplin	0	0	0	0
Arthur J. Barlocker	4,000	2,000%	0	0
Leo Reeve	150	.075%	0	0
Doyle Sampson	1,500	.750%	0	0
K. C. Weaver	0	0	0	0
Totals	5,650	2.825%	0	0

Some time during September and again in November of 1961, the plaintiffs were approached by the defendant Sampson who told them about B & E. He told them, among other things, that the investment potential of B & E was good and solicited their investment in the capital stock of the company. At the time he made the contract he was an agent of the defendant B & E (R. 302). Neither Sampson nor anyone else ever delivered a prospectus concerning B & E to the Hirschis. Pursuant to these solicitations the Hirschis purchased shares of stock in B & E as follows:

Date	*No. of Shares*	*Class*	*Consideration*
9-27-61	10,000	A Preferred	$10,000.00
11-30-61	10,000	B Preferred	10,000.00
11-30-61	800	Common	800.00

Since the time they purchased their shares, the Hirschis have been, both beneficially and of record, the sole owners of the shares.

After the Hirschis purchased their stock, they received dividends totaling $2,500.00: $500.00 in 1961, $1,000 in 1962, and $1,000.00 in 1963 (R. 304).

In their Second Amended Complaint, the plaintiffs sought

damages for the claimed violation of Rule 10b-5 and such other relief as might be appropriate for the claimed violation of the Investment Company Act of 1940. Plaintiffs' claim under the latter Act was dismissed by the Trial Court and that dismissal was sustained as to your petitioners by the Court of Appeals. Accordingly, it is not the subject of this petition.

The first real problem to confront the Trial Court in this case was the question of whether the suit had properly been instituted as a class action. In attempting to bring this suit as a class action plaintiffs alleged in their Second Amended Complaint that they were approached by one of the defendants, Sampson, who gave them certain information concerning B & E as above indicated. In ¶ 11 of the Second Amended Complaint, plaintiffs listed a number of things which the defendants allegedly *failed* to disclose to the plaintiffs at the time they were purchasing their stock (R. 57-59). Since the suit was brought more than four years after the last date on which plaintiffs had purchased their stock, the plaintiffs inserted some allegations in their Second Amended Complaint which were designed to overcome the bar of the appropriate statute of limitations, which is three years.[1]

In August of 1966, upon the motion of your petitioners,

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[1]78-12-26, Utah Code Annotated, 1953. Within three years — Within three years:

* * *

(3) An Action for relief on the ground of fraud or mistake; but the cause of action in such case shall not be deemed to have accrued until the discovery by the aggrieved party of the facts constituting the fraud or mistake.

78-12-27, Utah Code Annotated, 1953. Action against corporate stockholders or directors. — Actions against directors or stockholders of a corporation to recover a penalty or forfeiture imposed, or to enforce a liability created, by law must be brought within three years after the discovery, by the aggrieved party, of the facts upon which the penalty or forfeiture attached, or the liability accrued, . . .

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the Trial Court dismissed the class action portion of plaintiffs' complaint and in a carefully reasoned opinion, explained why he did so. That opinion is printed hereafter in Appendix "A".

Thereafter the case proceeded to trial as a suit brought by the individuals solely. A pretrial order was entered (R. 297-318) by which the contested and uncontested issues were set out. It was agreed that no prospectus was ever given plaintiffs and that certain information of the kind normally found in a prospectus was not furnished. The contested issues at the trial were essentially: 1) What was told to the plaintiffs about B & E, 2) Upon what facts did the plaintiffs rely in reaching their decision to purchase their stock, 3) When did plaintiffs discover, or when should they have discovered, the facts upon which their claim was based to start the running of the appropriate statutes of limitations, 4) Whether B & E was an investment company as defined by the Investment Company Act of 1940 [15 U.S.C. §80a-1 et seq], 5 Whether the individual defendants, or any of them, were controlling persons as that term is defined by the Investment Company Act of 1940, and 6) What damages, if any, were plaintiffs entitled to recover.

The trial of the cause took five days, two and a half days of which consisted of receiving evidence, both oral and written. The evidence covered the entire gamut of B & E's operations from its organization up to the time of trial. All of its financial statements were received in evidence at the behest of plaintiffs who sought to show thereby that B & E was an Investment Company. Witnesses, including plaintiffs, testified as to the content of any communications to plaintiffs concerning B & E.

At the outset of the trial plaintiffs had requested that certain instructions be given to the jury (R. 365-404), among them the following pertaining to damages:

"PLAINTIFFS' PROPOSED INSTRUCTION TO JURY NO. 32

In a sale of securities by fraudulent methods, the plaintiffs are entitled to recover the difference between the amount paid for the securities and *the real or actual value at the date of the sale,* together with any additional outlays or losses which are actually attributable to the fraudulent conduct. In other words, plaintiffs may recover all losses which were foreseeable at the time of the fraudulent conduct (R. 401). [Emphasis supplied]

"PLAINTIFFS' PROPOSED INSTRUCTION TO JURY NO. 33

The real or actual value of the securities purchased by plaintiffs *at the time of their purchase* may be affected by the purposes to which defendants intended to apply the assets of the corporation, and the manner in which they intended to manage the affairs of the corporation, even though the plaintiffs did not discover the facts in relation thereto until a later date. In determining the value of the securities at the date of sale, you may take into account all subsequent events such as any acts of self interested management, which you believe were contemplated by defendants at the time of sale, or any events which naturally flow from the things which the defendants did know and intend with respect to the management of B & E Securities, Inc. (R. 403). [Emphasis supplied]

The jury was requested to answer a series of Special Interrogatories, No. 14 of which dealt with the value of the stock purchased by the plaintiffs on various dates, which included the date of purchase, the date the suit was filed and the date of the trial. The Court, in a paraphrase of the instructions requested by plaintiffs, told the jury that they could determine the values on the dates in question "in light of the true facts" (R. 1426) and further instructed the jurors:

> Just because you don't have a balance sheet or specific information as to the precise date doesn't prevent you from drawing reasonable interferences, if you can do so on the basis of the greater weight or preponderance of the evidence; . . . (R. 1427)

The plaintiffs' counsel also advised the jury to determine values by looking to the financial statements. (R. 1380)

The jury rendered its verdict by which it found 1) that the defendants were guilty of omissions and misrepresentations about B & E plaintiffs and that the plaintiffs relied thereon; 2) fixed the dates when the plaintiffs discovered or should have discovered the facts upon which their claim was based, both as to the Rule 10b-5 claim and as to the Investment Company claim, 3) determined that B & E was an Investment Company, 4) found that for purposes of the Investment Company Act, your petitioners were not "controlling persons", and 5) determined the value of plaintiffs stock on the various dates requested. The jury determined that on the date of the purchase the preferred stock had a value of $1.00 and the common stock had a value of sixty cents; as to all other dates the jury found the stock had no value.

Thereafter, on June 26, 1967, the Trial Court entered its Findings of Fact and Conclusions of Law and Judgment (R. 553-566). The essence of them was that the defendants were liable to plaintiffs for a violation of § 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j) and Rule 10b-5 (17 C.F.R. § 240.10b-5); that B & E was an Investment Company as defined by the Investment Company Act of 1940 (15 U.S.C. §§ 80a-1 et seq.) but that plaintiffs were barred from recovery under that act by virtue of the applicable statutes of limitation; that in any event your petitioners were not "controlling persons" as that term is defined under the Investment Com-

pany Act; and he found the damages to which plaintiffs were entitled as the result of the Rule 10b-5 violation.

In connection with the damages, the Court found as follows:

> 19. To the extent it is controlled by the special verdict of the jury and based thereon the court finds that the common stock of B & E Securities, Inc., had a reasonable value of sixty cents per share and the Class A and Class B Preferred Stock of B & E Securities, Inc. had a reasonable value of One Dollar per share at the time of the plaintiffs' purchase, and the court finds in this connection that such "reasonable value" referred to in this finding constituted the existing book value of said securities at said time and did not take into account the future actual developments based upon and involving the deceptive conduct of said defendants which proximately caused and culminated in a greatly reduced value for said securities. (R. 561)
>
> 20. That the common stock and the Class A and Class B Preferred stock of B & E Securities, Inc. had no reasonable value at the date of the commencement of this lawsuit, December 1965, and at the time of trial herein. The court, based upon what it regards as the uncontrovertible evidence, finds that on *January* 25, 1963, *when plaintiffs were charged with notice of said defendants' fraud said stock had a reasonable and actual value of less than twenty-five cents per share;* that the valuation at said time was not submitted to the jury and the court finds the same in accordance with its reserved power. (R. 561,562) [Emphasis supplied]

The Trial Court then ruled that the plaintiffs should have judgment for $15,600.00 and concluded his Conclusions of Law by saying:

> 10. That if the findings of the court as to value as of the time of plaintiffs' discovery of said defendants' fraud are held ultimately not controlling, so that the plaintiffs' allowable damages are limited to $320 on the

> present record, said damages being obviously and grossly inadequate under the undisputed evidence, the court should entertain a motion for new trial on the issue of damages and attorneys' fees only, and hereby expresses its intention to grant such a new trial in that event. (R. 564)

No motion for new trial was made, and the case was appealed to the Circuit Court.

The questions presented on appeal (both by virtue of an appeal by your petitioners and a cross-appeal by plaintiffs) were:

1) Did the Trial Court apply the proper measure of damages? (i.e. was the date used in determining damages the proper one under existing Federal case law?)

2) Whether the Trial Court erred in dismissing the Class Action portion of plaintiffs' complaint under the provisions of Rule 23, Federal Rules of Civil Procedure.

3) Whether the Trial Court erred in its application of the appropriate statues of limitation to bar the Investment Company Act claim.

The main portion of the opinion of the Court of Appeals deals with whether the action as originally brought constituted a Class Action under Rule 23. Conceding that the issue is extremely close with respect to the 10b-5 claim, the Court of Appeals nevertheless decided that this case was an appropriate one for class action treatment and reversed the decision of the Trial Court in that respect. This is one of the rulings which this Petition asks this honorable court to review.

With respect to the statute of limitations question, the Court of Appeals ruled that the proper statute had been ap-

plied to your petitioners and sustained the dismissal of the Investment Company claim as to them, but held that B & E was liable under the Investment Company Act because a different limitations statute was applicable to it. This ruling is not questioned by this Petition.

Your petitioners had challenged the jurisdiction of the Federal District Court to entertain a civil claim based on the Investment Company Act by means of a Motion to Dismiss which had been denied. The issue had been preserved in the pretrial order. However, since the Trial Court had dismissed the Investment Company Act and since, even if your petitioners were found not to be protected against that claim by virtue of the limitations statutes they were protected by virtue of not being controlling persons, your petitioners did not pursue the question of jurisdiction under the Act. However, the Court of Appeals, on its own motion, determined that a private civil cause of action will lie under the Investment Company Act, and that B & E is liable thereunder. No issue is raised as to that ruling by this Petition.

As to the issue of damages, the Court of Appeals reiterated that the Federal rule respecting this question is the "out of pocket" damage rule and is espoused in *Estate Counseling Service, Inc. v. Merrill, Lynch, Pierce, Fenner and Smith, Inc.*, 303 F. 2d 527 (10th Cir. 1962), but that the question of the appropriate *date* for ascertaining damages was not before the court in that case. The Court of Appeals thus held that the appropriate date is the date of discovery by plaintiffs of their claim as determined by the jury and that therefore the judgment for damages entered by the Trial Court should be sustained. It is submitted that this decision is contrary to the long standing decisions of this court and other Federal Courts and is therefore properly the subject of review.

The final action by the Court of Appeals was to affirm the money judgment in favor of the named plaintiffs and to remand the case for further proceedings in accordance with the opinion.

ARGUMENT

ISSUE NO. 1. THE PROPER MEASURE OF DAMAGE IN THE FEDERAL COURTS IN THIS KIND OF CASE IS THE DIFFERENCE BETWEEN THE AMOUNT PARTED WITH AND THE VALUE OF THE THING RECEIVED AT THE DATE OF THE TRANSACTION, AND THE COURT OF APPEALS HAS DECIDED THIS ISSUE IN A WAY WHICH IS IN CONFLICT WITH APPLICABLE DECISIONS OF THIS COURT.

At the start of the trial of this case the proposition for which your petitioners are contending was recognized without question by plaintiffs. This is demonstrated by their requested Jury Instructions No. 32 and 33 (R. 401, 403) previously alluded to (p. 15), and by their request at the start of the trial, that an interrogatory be submitted to the jury which stated: "What do you find to be the reasonable value of the stock purchased by plaintiffs?" (R. 417). This recognition of that proposition on the part of the parties arose out of the following direct statement by the Court of Appeals for the Tenth Circuit in *Estate Counseling Service, Inc. v. Merrill Lynch, Pierce, Fenner and Smith, Inc.*, 303 F.2d 527, (10th Cir., 1962) at 533:

> The failure to show actual damages is also a fatal defect in the cause of action based on the Securities Exchange Act of 1934, 15 U.S.C.A. Sec. 78a et seq. That Act permits recovery of "his actual damages on account of the act complained of." "Actual damages," under the Federal rule of damages for fraud is the "out of pocket rule." In the Federal courts the measure of damages recoverable by one who through fraud or misrepresen-

> tation has been induced to purchase bonds or corporate stock, is the difference between the contract price, or the price paid, and the real or actual value *at the date of the sale,* together with such outlays as are attributable to the defendant's conduct. Or in other words, the difference between the amount parted with and the value of the thing received. *Smith v. Bolles,* 132 U.S. 125, 10 S. Ct. 39, 33 L.Ed. 279; *Sigafus v. Porter,* 179 U.S. 116, 21 S. Ct. 34, 45 L .Ed. 113; *Hindman v. First Nat. Bank,* 6 Cir., 112 F. 931, 57 L.R.A. 108, cert. den. 186 U.S. 483, 22 S. Ct. 943, 46 L.Ed. 1261; *Tooker v. Alston,* 8 Civ., 159 F. 599, 16 L.R.A., N.S., 818; *Chandler v. Andrews,* 2 Cir., 192 F. 543; *Nashua Sav. Bank v. Burlington Electric Lighting Co.,* CC 100 F. 673. Contra, see *Southern Ice Co. v. Morris,* 5 Cir., 219 F. 551; *Towle v. Maxwell Motor Sales Corp.,* 8 Cir., 26 F.2d 209; *Florence v. Crummer,* 5 Cir., 93 F.2d 542, cert. den. 304 U.S. 563, 58 S. Ct. 944, 82 L. Ed. 1530. [Emphasis suplied.]

The decision of the Trial Court, affirmed by the Court of Appeals, measures the damages on the date the plaintiffs discovered their cause of action as that date was found by the jury.

The opinion of the Court of Appeals in this case avers that the question of the date was not before it in the *Estate Counseling Service* case and was not decided. It is submitted, however, that not only was the date a factor in the *Estate Counseling Service* case, as is evident from the portion quoted above, but other cases consider it a factor also. The cases cited in the *Estate Counseling Service* case by the Court of Appeals for the Tenth Circuit clearly demonstrate that the date for ascertaining damages is a factor.

For example, in one of the cases cited, *Sigafus v. Porter,* 179 U.S. 116 (1900), the Court states that it adheres to the doctrine of *Smith v. Bolles,* 132 U.S. 125 (1889) and states at page 125 of 179 U.S.:

> . . . Upon the assumption that the property was not worth what the plaintiffs agreed to give for it, they were entitled to have—if the evidence sustained the allegation of false and fraudulent representations upon which they were entitled to rely and upon which they in fact relied—a verdict and judgment representing in damages the difference between the real value of the property *at the date of its sale* to the plaintiffs and the price paid for it, with interest from that date, and, in addition, such outlays as were legitimately attributable to the defendant's conduct, but not damages covering "the expected fruits of an unrealized speculation." [Emphasis supplied]

Again, in *Nashua Sav. Bank v. Burlington Electric Lighting Co.*, 100 F. 673 (CC Iowa, 1900) [also relied on in the *Estate Counseling Service* case], the Court stated, at page 675:

> . . . In placing before the jury the facts to be considered in determining the fair value of the property in the condition in which it was *when sold*, it is competent to show the character and cost of the repairs needed to put the plant in condition for use, not that this outlay is to be deemed an element of the money damages, but the same is a matter of fact or evidence for the consideration of the jury upon the question of the *actual value* of the property. . . . [Emphasis supplied]

And in *Hindman v. First Nat. Bank*, 6 Cir., 112 F. 931, 57 L.R.A. 108, cert. den. 186 U.S. 483, 22 S. Ct. 943, 46 L.Ed. 1261 [also relied on in the *Estate Counseling Service* case] the Court said, at page 936 of 112 F:

> . . . The rule seems to be that the damages recoverable in an action for deceit, where the plaintiff has been induced to purchase shares in reliance upon untrue representations, is the difference between the price paid and the real intrinsic value of such shares *at the time of their purchase;* and that such value is to be ascertained in the *light of subsequent events* in the history of the company, and not by the market price. . . . [Emphasis supplied]

All of the cases relied upon by the Court in the *Estate Counseling Service* case measured damages on the date of the transaction. *Janigan v. Taylor*, 344 F.2d 781 (1st Cir., 1965) cert. den. 382 U.S. 879, 86 S. Ct. 163 (1965) relies on *Sigafus v. Porter*, supra, in measuring damages "at the date of its [the stock] sale" in a 10b-5 suit, as well as on the *Estate Counseling Service* case. (344F.2d at 786)

In none of the cases cited by the Tenth Circuit as being *contra* to its ruling in the *Estate Counseling Service* case is the date when damages are to be measured at issue. As a matter of fact, in *Towle v. Maxwell Motor Sales Corp.*, (8 Cir. 1928), 26 F.2d 209, the damages are said to be measured at the date of the sale.

The only recent case to consider a variation in the so-called "out-of-pocket" rule of damages is *Myzel v. Fields*, 386 F.2d 718 (8th Cir. 1967), cert. den. 390 U.S. 951, 88 S. Ct. 1043 (1968). That case involved fraud perpetrated upon a seller by a buyer of stock and the applicable question was whether the seller should be entitled, as part of his damages, to the accretion in the value of the stock subsequent to the time he sold it. It was there held that where the accretion in value was attributable to factors which were in existence at the time of the sale but not known to the seller and the evidence further showed that had he known the true facts the seller would not have sold the stock, he was entitled to the increased value of the security. *Myzel v. Fields* distinguishes *Janigan v. Taylor*, supra, and the *Estate Counseling Service* case, *supra*, as ones which involved fraud committed on buyers, as distinguished from fraud on the seller, but makes no attempt to repudiate the rule as applied by the latter cases.

The plaintiffs, at the outset of the trial, submitted requests for instructions based on the rule of damages here con-

tended for (R. 401, 403). The plaintiffs' counsel, in his final argument, asked the jury to determine value from financial statements (R. 1380, 1381). The Trial Court instructed the jury to find the value at the date of the sale "in light of the true facts." (R. 1426, 1427)

The jury returned its verdict finding the value of the stock purchased by plaintiffs on the date of the sale (R. 338), which would have resulted in a judgment in favor of plaintiffs in the sum of $320.00.

Notwithstanding the fact that the entire matter had been submitted to the jury through instructions, interrogatories and argument in accordance with the cases above cited, the Trial Court apparently felt that the damages found by the jury were inadequate, but rather than taking the action which a trial court might in such circumstances, he instead found the value of the stock on the date the plaintiffs were deemed to have discovered their cause of action, as found by the jury, under his reserved power as provided in Rule 49(a), Federal Rules of Civil Procedure, and measured the damages to which plaintiffs were entitled by the difference between the value so found and the price paid for the stock. It was this measure of damages which was affirmed by the Court of Appeals.

The problems inherent in this finding are legion. Whereas a finding by the jury in the case could have been held applicable to all members of the class, because the value had been found on the date of the sale, the situation now is that the damages are to be measured as of the date each member of the class discovered his cause of action. Accordingly, the case must be resubmitted to a trier of fact to find out (a) when each member of the class discovered his cause of action and (b) if that member is not barred by the statute of limitations, what was the value of his stock on that date. The problems inherent in trying those questions as to each member of the class make the mind boggle.

Your petitioners submit that the value brought in by the jury is the one on which the judgment should be based for purposes of this case, and that the decision of both the Trial Court and the Court of Appeals is in error and contrary to the historical measure of damages established by this Honorable Court.

ISSUE NO. 2. FOR THE PURPOSE OF APPLYING THE CRITERIA OF RULE 23(b) (3), F. R. CIV. P., THE COURT SHOULD DETERMINE WHETHER THE *LITIGATED* ISSUES COMMON TO THE MEMBERS OF THE CLASS PREDOMINATE OVER SUCH ISSUES PECULIAR TO THE INDIVIDUAL, AS DISTINGUISHED FROM *ALL* OF THE ISSUES WHICH MIGHT BE RAISED.

This suit was filed December 2, 1965, more than four years after the individual plaintiffs had purchased their stock in B & E and more than three and a half years after all the stock had been sold to all of the members of the alleged class. The appropriate statutes of limitation applicable to the individual defendants was three years.[1]

The Second Amended Complaint was divided into two causes of action. The first cause of action was based on a claimed violation of §10(b), Securities Exchange Act of 1934 (15 U.S.C. §78j), and Rule 10b-5 of the United States Securi-

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[1]78-12-26, Utah Code Annotated, 1953. Within three years — Within three years:

. . .

(3) An Action for relief on the ground of fraud or mistake; but the cause of action in such case shall not be deemed to have accrued until the discovery by the aggrieved party of the facts constituting the fraud or mistake.

78-12-27, Utah Code Annotated, 1953. Action against corporate stockholders or directors. — Actions against directors or stockholders of a corporation to recover a penalty or forfeiture imposed, or to enforce a liability created, by law must be brought within three years after the discovery, by the aggrieved party, of the facts upon which the penalty or forfeiture attached, or the liability accrued, . . .

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ties and Exchange Commission promulgated thereunder (17 C.F.R. §240.10b-5). For ease of reference that cause of action will hereafter be referred to as the "10b-5 Claim". The second cause of action was based on a claimed violation of the Investment Company Act of 1940 (15 U.S.C. §80a-1 et seq.) and for ease of reference that cause of action will hereafter be referred to as the "Investment Company claim".

The complaint alleged, as to the 10b-5 claim, that defendants had made certain oral representations to plaintiffs concerning B & E and in addition had failed to disclose a number of enumerated facts to plaintiffs and to other members of the class, which facts, plaintiffs alleged, were material. (R. 54, 57-59) In the final Pretrial Order it was admitted that no written information concerning B & E was ever given to the plaintiffs prior to their purchase of their stock by any of the defendants. (R. 303, 304) Thus the only issues of fact which were earnestly disputed at the trial in connection with the 10b-5 claim, as had been foreseen by the Trial Court, were: 1) when did the plaintiffs discover or when should they have discovered their cause of action, 2) what had been told them orally by the defendants, 3) upon what did they rely in determining to purchase their stock, and of course 4) what were their damages.

As to the Investment Company claim, the complaint alleged simply that B & E was an Investment Company as that term was defined in the Act, that it had not registered under the Act and therefore all contracts entered into by B & E, including the sale of its stock, were void. It was further alleged that the individual defendants, as officers, directors and agents, were individually liable, as was the company. In the Final Pretrial Order, it was admitted that B & E had never complied with any of the provisions of the Investment Company Act,

but B & E denied that it was an Investment Company and asserted that any claim based on the Investment Company Act was barred by the appropriate statutes of limitations. In addition, however, it was noted that by virtue of § 2(a) (9) of the Investment Company Act of 1940 (15 U.S.C. § 80a-2(a) (9)) your petitioners were presumed *not* to be controlling persons and therefore not liable as individuals under the Investment Company Act, even if the plaintiffs otherwise prevailed on all of the other aspects. The jury affirmed this presumption.

In the Summer of 1966, petitioners filed a motion with the Trial Court asking that plaintiffs' complaint be dismissed as a class action. While the issues had not been formalized at that time, both court and counsel knew quite well over what issues the battle would be fought.

On August 9, 1966, the Trial Court granted your petitioners' motion in a Memorandum Decision reported at 41 F.R.D. 64 (D.C. Utah, 1966) and printed in Appendix "A". In so doing, the court recognized that there were some common questions of fact and law involved in the action, but determined that the really "primary" issues involved the nature of the representations, reliance and the date of discovery which would determine whether plaintiffs were barred by the statutes of limitations.

Th Trial Court's decision was made very shortly after the new Rule 23 became effective and he gave considerable thought to the new rule, both from his own views and the views of those who had had occasion to write on the subject, particularly the Advisory Committee's Notes, 39 F.R.D. 69.

The new Rule 23 provides in material part:

RULE 23.

CLASS ACTIONS

(a) Prerequisites to a Class Action. One or more members of a class may sue or be sued as representative parties on behalf of all *only* if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) *the claims or defenses of the representative parties are typical of the claims or defenses of the class,* and (4) the representative parties will fairly and adequately protect the interests of the class.

(b) Class Actions Maintainable. An action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

* * *

(3) *the court finds that the questions of law or fact common to the members of the class predominate over any questions affecting only individual members,* and that a class action is superior to other available methods for the fair an defficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) *the difficulties likely to be encountered in the management of a class action.*

(c) Determination by Order Whether Class Action to be Maintained; Notice; Judgment; Actions Conducted Partially as Class Actions.

(1) As soon as practicable after the commencement of an action brought as a class action, the court shall determine by order whether it is to be so maintained. An order under this subdivision may be condi-

tional, and may be altered or amended before the decision on the merits. [Emphasis supplied.]

* * *

The new Rule, in Subdivision (a), sets out some broad general requirements without *all* of which a class action cannot be maintained. Subdivision (b) then states that a class action *may be maintained* if the requirements of subdivision (a) are satisfied and in addition, certain other prerequisites are met.

In commenting on how the new Rule would be applied, the Advisory Committee on the new Rules stated:

> "The court is *required* to find, *as a condition of holding that a class action may be maintained under this subdivision*, that the questions common to the class predominate over the questions affecting individual members. It is only where this predominance exists that economies can be achieved by means of the class-action device. In this view, a fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for a class action, and it may remain so despite the need, if liability is found, for separate determination of damages suffered by individuals within the class. On the other hand, although having some common core, *a fraud case may be unsuited for treatment as a class action if there was material variation in the representation made or in the kinds or degrees of reliance by the persons to whom they were addressed.* See *Oppenheimer v. F. J. Young & Co., Inc.*, 144 F. 2d 387 (2d Cir. 1944); *Miller v. National City Bank of N. Y.*, 166 F. 2d 723 (2d Cir. 1948); and for like problems in other contexts, see *Hughes v. Encyclopedia Britannica*, 199 F. 2d 295 (7th Cir. 1952); *Sturgeon v. Great Lakes Steel Corp.*, 143 F. 2d 819 (6th Cir. 1944). A "mass accident" resulting in injuries to numerous persons is ordinarily *not appropriate* for a class action because of *the likelihood that significant questions, not only of damages but of liability and de-*

> *fenses to liability*, would be present, affecting the individuals in different ways. In these circumstances an action conducted nominally as a class action would *degenerate in practice into multiple lawsuits separately tried.* See *Pennsylvania R. R. v. United States*, 111 F. Supp. 80 (D. N.J. 1953); cf. Weinstein, *supra*, 9 Buffalo L. Rev. at 469. Private damage claims by numerous individuals arising out of concerted antitrust violations may or may not involve predominating common questions. (Citing cases)" [Emphasis supplied.] Advisory Committee's Notes to Proposed Rules of Civil Procedure, 39 F.R.D. 69, at 103.

It is submitted that the purpose of the new Rule 23 is to enable the courts to use the class action device where it would "achieve economies of time, effort, and expense, and promote uniformity of decision as to persons similarly situated, without sacrificing procedural fairness or bringing about other undesirable results." Advisory Committee's Notes to Proposed Rules of Civil Procedure, 39 F.R.D. 69, at 102. In order to achieve that end, the Trial Court must consider what issues will be contested, where the "battle will be fought", and decide whether *those* issues are common to the class or must be individually determined. This the Trial Court did and properly dismissed the complaint as a class action.

The Court of Appeals, however, took a different approach. That court looked first to the Investment Company claim, and stated that this was clearly a proper case for a class action, because the plaintiffs need only "show that B & E was an investment company, that it had not registered and that the individual defendants were controlling persons, the activities of the plaintiffs could have little or no effect upon the operative facts determining liability." 402 F. 2d 94 at 99. We submit that this statement is not correct. The "activities of the plaintiffs" not only *could* have direct effect in determining liability, but it was actually their activities (i.e., the date they discovered

their cause of action under the Investment Company Act) that barred them from recovery under the Investment Company claim. While it is true that whether B & E was an investment company and whether it had registered and whether the individual defendants were controlling persons were determinations that could be made without involving the plaintiffs, the registration issue had been admitted and the individual defendants were presumed not to be controlling persons and petitioners submit that the determining factor, not just an operative factor, was the date of discovery by the plaintiffs of their claim. In this connection the jury determined that date in such a manner as to bar plaintiffs' claim against all of the individual defendants and this determination was affirmed by the Court of Appeals.

The Court of Appeals, having satisfied itself that the Investment Company claim justified the maintenance of the class action on the basis of what we submit is an erroneous premise, then turned its attention to the 10b-5 claim. The Court there conceded that the question of class action was an "extremely close question" (402 Fed. 2d at page 99). However, in justification of its ruling that the class action should have been allowed, the Court of Appeals points to the allegations of the Complaint wherein it was alleged that numerous facts concerning B & E were not told to the plaintiffs at the time they purchased their stock. However, those omissions were admitted by the defendants and were never at issue as a contested matter. The real contest, as noted by the Trial Court, was over what plaintiffs had been told, when they discovered they had a cause of action under 10b-5 and what their damages were. When one examines the 10b-5 claim in the light of the contested issues it is quite clear that the operative or controlling facts on liability will rest at least as much, if not more so, with the knowledge of each individual plaintiff than it will

with the actions of the defendants which are common to all plaintiffs. The preponderance of the individual issues is even more pronounced if each plaintiff's damages are to be measured as of the date on which he discovered or should have discovered the existence of his cause of action. That was the measure of damage applied by the Trial Court and approved by the Court of Appeals as discussed in Issue No. 1, supra. If that ruling is allowed to stand it will introduce a new issue which will be peculiar to each member of the class, i.e., the value of the stock purchased on the date the member discovered his cause of action.

The Court of Appeals, in examining into whether the class action in this case was superior to other procedural devices available, notes that the class action device is particularly desirable to enforce the Securities laws and any error, if there is to be one, should be committed in favor of allowing the class action. Your petitioners recognize that the courts and the law desire to protect the "little guy" who invests his money in a company without being properly informed about that company. However desirable this social philosophy may be in the abstract, it should not be used as a weapon to deprive defendants of the procedural protections historically made available to them. We submit that however desirable the class action device may be, it must be viewed in each case in the context of the facts of *that* case.

Nowhere in these proceedings to date has there been a case cited which has held that the class action device was appropriate where the operative facts that determine liability did not rest almost entirely with the defendants. We submit that the record in this case demonstrates that the date of discovery by the plaintiffs of their cause of action is not an abstract issue. Not only is that date peculiar to each plaintiff, but the jury

found that the date applicable to the 10b-5 claim was different from the date applicable to the Investment Company claim *as to the same plaintiffs*. This difference resulted in the plaintiffs being barred from recovery on the one claim but entitled to recovery on the other.

The plaintiffs below and the Court of Appeals referred to two cases which have interpreted the new Rule 23. They were *Kronenberg v. Hotel Governor Clinton, Inc.*, 41 F.R.D. 42 (SDNY 1966) and *Dolgow v. Anderson*, 43 F.R.D. 472 (EDNY 1968). In *Kronenberg* it was claimed there that there were a number of different misrepresentations to different members of the class and that this took the case out of the class action rule. But the court said that though the misrepresentations might vary, they were the product of a common scheme and class action was appropriate. At the time the opinion in that case was handed down, there had been no answer filed and the court indicated that if the misrepresentations did vary materially he might consider amending his ruling. There was no question in that case of the statute of limitations.

In *Dolgow* the defendants raised three issues which they said would predominate as to the individuals over the common questions: reliance, statute of limitations and damages. But, according to the brief filed *amicus curiae* by the Securities Exchange Commission in that case, the statute of limitations had clearly not run and therefore that question was not before the court. Judge Weinstein made only passing reference to the limitations issue in his opinion.

How it can be claimed that the limitations issue, which is really determinative of liability, can be held not to predominate over the other issues, many of which were virtually admitted, is difficult to understand. If the case is remanded to proceed as

a class action, a proper defense of the case would require the defendants, through discovery, to attempt to ascertain the date that each member of the class discovered his or her cause of action. That issue will require a separate trial as to each member of the class and if the ruling on the date on which the damages is to be measured is allowed to remain, then it will be necessary to determine the value of the stock purchased by each plaintiff on the date he discovered his cause of action as that date is determined by the jury. How the class action device can be said to be "superior to other available methods for the fair and efficient adjudication of the controversy" (Rule 23 (b) (3) is difficult, if not impossible, to understand.

The Trial Court was correct. This case should not be tried as a class action.

ISSUE NO. 3. IF THE SUIT IS ALLOWED TO PROCEED, THE COURT SHOULD REQUIRE THAT THE ACTION PROCEED ONLY AS AN INDIVIDUAL ACTION AS TO THOSE ISSUES WHICH ARE NOT APPROPRIATE FOR CLASS ACTION TREATMENT UNDER THE AUTHORITY OF RULE 23 (c) (4) (A), F.R. Civ. P.

This issue has never been raised prior to this Petition because this is the first time the necessity for raising it has occurred. The issue is one, however, which is fairly encompassed in Issue No. 2.

The Trial Court dismissed the plaintiffs' Complaint as a class action. The Court of Appeals reversed that holding and directed the case to proceed as a class action. However, we have previously noted that there are certain issues which are peculiar to each so-called member of the class. It should also be noted that there are certain defendants which stand in a

different position with respect to liability under the Investment Company claim. Your petitioners, as has been noted, were presumed not to be controlling persons under the Investment Company Act, whereas, the other individual defendant and the company had no such presumption. The finding of the jury supported this presumption. If it is deemed advisable to affirm the ruling of the Court of Appeals and permit the action to proceed as a class action, then the action should only be allowed to be so maintained with respect to the issues concerning liability which are peculiar to the defendants' conduct. The case should proceed as an individual action only on the question of limitations, date of discovery by plaintiff of his claim and damages. This is clearly contemplated by the provisions of Rule 23(c) (4) which reads, in applicable part:

> (4) When appropriate (A) an action may be brought or maintained as a class action with respect to particular issues, . . . and the provisions of this rule shall then be construed and applied accordingly.

Thus, if this case is allowed to proceed as a class action, it should be so allowed only as to those questions which are common to the class. Each individual plaintiff should be required to appear in the action, subject himself to normal discovery procedure and be prepared to prove the date he discovered his cause of action and what his damages are.

CONCLUSION

It is respectfully contended that this court should grant this Petition for Writ of Certiorari. It is quite clear that the decisions of the lower courts with respect to damages are contrary to the decisions of this court and that the questions raised with respect to the class action device are such as require an interpretation by this Court which will assist courts all over the country in applying the new Rule 23. We submit that these questions justify the Court's granting this petition.

Respectfully submitted,

HARDIN A. WHITNEY, JR.
Of MOYLE & MOYLE

800 Deseret Building
Salt Lake City, Utah 84111

Attorneys for Petitioners

APPENDIX "A"

IN THE UNITED STATES DISTRICT COURT

FOR THE DISTRICT OF UTAH

CENTRAL DIVISION

LELAND LEE HIRSCHI and LaVERNE HIRSCHI, for themselves and all other persons similarly situated,

Plaintiffs,

vs.

B. & E. SECURITIES, INC., a Utah Corporation, WILLIAM A. BARLOCKER, LEE J. ESPLIN, K. C. WEAVER, LEO REEVE, ARTHUR BARLOCKER, W. B. HAIL and DOYLE SAMPSON,

Defendants.

No. C 243-65

MEMO-RANDUM DECISION

CHRISTENSEN, District Judge

Plaintiffs seek damages on behalf of themselves "and all other persons similarly situated" in their first claim for alleged violations of Section 10(b) of the Securities Exchange Act of 1934 (15 U.S.C. §78j),[1] and Rule 10b-5 promulgated by the United States Securities and Exchange Commission

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1 — "78j. Manipulative and Deceptive Devices

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce or of the mails, or of any facility of any national securities exchange —

". . . .

"(b) To use or employ, in connection with the purchase or sale of any security registered on a national securities exchange or any security not so registered, any manipulative or deceptive device or contrivance in contravention of such rules and regulations as the Commission may prescribe as necessary or appropriate in the public interest or for the protection of investors."

(17 C.F.R. Section 240.10b-5).[2] In a second claim damages are sought for violation of Section 7 of the Investment Company Act of 1940 (15 U.S.C. 80a-7).[3]

Plaintiffs are purchasers of stock of the defendant corporation. It is alleged in the second amended complaint that this stock was offered for sale and sold to plaintiffs by the defendants by means of devices, schemes and artifices to defraud and to obtain money from the plaintiffs by means of untrue statements of material facts and by omitting to state and concealing material facts necessary to make the statements made, in the light of the circumstances in which they

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2 — "§ 240.10b-5. Employment of Manipulative and Deceptive Devices.

"It shall be unlawful for any person, directly or indirectly, by the use of any means or instrumentality of interstate commerce, or of the mails or of any facility of any national securities exchange,

"(a) To employ any device, scheme, or artifice to defraud,

"(b) To make any untrue statement of a material fact or to omit to state a material fact necessary in order to make the statements made, in the light of the circumstances under which they were made, not misleading, or

"(c) To engage in any act, practice, or course of business which operates or would operate as a fraud or deceipt upon any person, in connection with the purchase or sale of any security."

3 — "§ 80a-7. Transactions by Unregistered Investment Companies.

"(a) No investment company organorized or otherwise created under the laws of the United States or of a State and having a board of directors, unless registered under section 80a-8 of this title, shall directly or indirectly —

"(1) offer for sale, sell, or deliver after sale, by the use of the mails or any means or instrumentality of interstate commerce, any security or any interest in a security, whether the issuer of such security is such investment company or another person; or offer for sale, sell, or deliver after sale any such security or interest, having reason to believe that such security or interest will be made the subject of a public offering by use of the mails or any means or instrumentality of interstate commerce;

". . . .

"(3) control any investment company which does any of the acts enumerated in paragraphs (1) and (2) of this subsection;

"(4) engage in any business in interstate commerce;

"(5) control any company which is engaged in any business in interstate commerce. . . ."

were made, true and not misleading, and otherwise engaged in acts and courses of business which acted as a fraud upon plaintiffs. Some of the alleged misrepresentations or omissions, if established, could have been made to, and could have affected all members of the alleged class in a similar manner as claimed in the complaint, but it is obvious that many of them were of such a nature as to make it highly unlikely that all or even a substantial part of the stock purchasers would have received the same communications or, if they had, with similar impact, effect or context. In any event, it would be impossible in a case such as this to describe the class sufficiently to permit a meaningful judgment in its favor upon initial submission of the case to a jury.

At a pre-trial conference on June 30, 1966, the parties were allowed time within which to brief the question of the propriety of treating the action as a class action. On July 15, 1966, the question was argued orally to the court in connection with arguments concerning similar problems in other cases, and the questions are now before the court for decision.

This action was begun on December 2, 1965. In the second amended complaint it is alleged that during the period from on or about February 20, 1961, to on or about May 7, 1962, the defendants sold securities at various prices to approximately two hundred persons. The acquisitions of the named plaintiffs were on September 27, 1961, and November 30, 1961. In order to avoid the bar of the statute of limitations thus indicated, plaintiffs in their second amended complaint allege active concealment from stockholders of the causes of action now asserted and "lulling" activity on the part of the defendants. It is asserted that plaintiffs did not know, and that none of the other stockholders knew any of the true material facts concerning B. & E., until some time in 1965,

when plaintiffs employed legal counsel to investigate plaintiffs' investment; and that they could not, by reasonable process of inquiry, have ascertained the material facts prior to the date of the commencement of this action on their behalf.

Defendants contend that this may not be properly treated as a class action, either under Rule 23(a)(3)[4] as it existed prior to July 1, 1966, or under Rule 23(a), (b)(3) of the Federal Rules of Civil Procedure[5] as they were amended effective July 1, 1966.

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4 — "Rule 23. Class Actions

"(a) Representation. If persons constituting a class are so numerous as to make it impracticable to bring them all before the court, such of them, one or more, as will fairly insure the adequate representation of all may, on behalf of all, sue or be sued, when the character of the right sought to be enforced for or against the class is

". . . .

"(3) several, and there is a common question of law or fact affecting the several rights and a common relief is sought."

5 — "Rule 23. Class Actions

"(a) Prerequisites to a class action. One or more members of a class may sue or be sued as representative parties on behalf of all only if (1) the class is so numerous that joinder of all members is impracticable, (2) there are questions of law or fact common to the class, (3) the claims or defenses of the representative parties are typical of the claims or defenses of the class, and (4) the representative parties will fairly and adequately protect the interests of the class.

"(b) Class actions maintainable. Any action may be maintained as a class action if the prerequisites of subdivision (a) are satisfied, and in addition:

". . . .

"(3) the court finds that the questions of law or fact common to the members of the class predominate over any question affecting only individual members, and that a class action is superior to other available methods for the fair and efficient adjudication of the controversy. The matters pertinent to the findings include: (A) the interest of members of the class in individually controlling the prosecution or defense of separate actions; (B) the extent and nature of any litigation concerning the controversy already commenced by or against members of the class; (C) the desirability or undesirability of concentrating the litigation of the claims in the particular forum; (D) the difficulties likely to be encountered in the management of a class action."

There are some common issues of fact and law involved in this action. On the other hand it appears that there are questions of law and fact affecting the individual members of the class which could not be common to all of the members of the class. For example: Whether the individual members relied upon specific or any oral representations made to them and not to members of the class in general; whether there was reliance upon representations made to others, and whether the particular member had knowledge or notice of the alleged causes of action early enough to be barred by the statute of limitations. These, I apprehend, may become primary issues in the case. It seems inevitable before the case can be meaningfully submitted to a jury that all claimants seeking the aid of the court must be identified and must be brought before the court by some means in order to have these and other issues determined.

I have considered whether subdivisions of the class could be established to cover the individual issues or categories thereof. This seems infeasible, if not impossible, however, and by attempting to fragmentize the class the case would be made more complex to no avail, for ultimately the individual claimants would have to come before the court. There have been enough difficulties encountered from a conceptual as well as a practical viewpoint, in *Union Carbide and Carbon Corporation v. Nisley*, 300 F.2d 561 (10th Cir. 1962), to commend the avoidance of its procedure under the old rule when the operative facts on liability, unlike those in that case, are not common to the alleged class.

Short of extending old Rule 23 even beyond *Nisley*, on facts much less hospitable, no useful purpose would be served by proceeding further under it. Being a rule primarily for liberal intervention, utilization of the spurious class action

device likely would not ameliorate the statute of limitations problem for stockholders not parties or intervenors at the time of trial; and the jurisdictional hurdle because of individual claims limited in amount, which it might otherwise be impossible to surmount, is of little practical concern in this 10(b) action.

It would be within the discretion of the court upon invocative facts in a case pending when the amendment to Rule 23 went into effect, to proceed either under the old or new rule. For reasons which already must be apparent, I have concluded that the new rule offers no practical solution. Having found that the questions of law and fact common to the members of the alleged class do not predominate over questions affecting individual members, the basis for the application of the rule does not exist. Rule 23(b)(3) F.R.C.P. If there could be thought some question about this, the difficulties likely to be encountered in the management of a class action in this case, and the relatively limited benefits, if any, such an action could accomplish at greatly increased burden, have persuaded me to exercise whatever discretion I possess in proceeding otherwise. That is not to say that even in 10(b) actions involving oral as well as written representations and the question of reliance I think the class action device is of necessity unsuitable. But with the predominate factual question of the application or tolling of the statute of limitations superimposed upon the other individual problems I believe that this case involves even more of a contraindication than the Advisory Committee had in mind when it annotated its proposed amendments to Rule (b)(3) with the following comment:

> "The court is required to find, as a condition of holding that a class action may be maintained under this subdivision, that the questions common to the class predominate over the questions affecting indi-

> vidual members. It is only where this predominance exists that economies can be achieved by means of the class-action device. In this view, a fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for a class action, and it may remain so despite the need, if liability is found, for separate determination of the damages suffered by individuals within the class. On the other hand, although having some common core, a fraud case may be unsuited for treatment as a class action if there was material variation in the representations made or in the kinds or degrees of reliance by the persons to whom they were addressed. Proposed Rules of Civil Procedure, Advisory Committee Notes, 355 Fed. 2d 5, 35 (1966); reported to Congress, House Document No. 391, p. 42, 89th Congress, 2d Session, 1966."

What has been said largely applies also to plaintiffs' second claim, asserting violation of the Investment Companies Act. The question of law whether a civil action may be maintained thereunder at all and whether with reference to the alleged failure to register the members of the alleged class are so bound by public records as to be barred by the statute of limitations, would lead themselves to class adjudication. Yet these are only threshhold questions which, if resolved against plaintiffs, would render failure to involve a class possibly prejudicial only to the defendants, who themselves object to the class action. And if they were resolved in favor of plaintiffs this would still not obviate the serious individual problems of knowledge, notice, reasonable inquiry and concealment relating to the statute of limitations.

Moreover, to proceed with the first claim as an individual action and the second claim as a class action would involve risk of intensifying and prolonging the illusory representation with prejudcial effect as to the statute of limitations which it has been suggested may already have occurred by reason

of the pendency of the class action as a matter of nomenclature in the complaint. I refer to the indication that would be given by sending out a notice pursuant to Rule 23(c)(1) concerning the second claim that the interest of all nondissenting stockholders would be represented and the effect by way of discouragement or confusion that such a notice could have upon essential intervention with reference to the first claim. If beyond the mandatory requirements of the present rule the notice sought to negate the inference of complete class representation by calling attention to the desirability or necessity of individual intervention with reference to the first claim, the court could well find itself in the position not only of soliciting intervenors but clients. See *Cherner* v. *Transitron Electronic Corporation*, 201 F. Supp. 934 (D. Mass. 1962). On the other hand, if stockholders intervene in the 10(b) claims, as appears likely in view of their concentration in a relatively small community, they can conveniently do so with respect to the second claim; and if they would find it necessary to appear at or before the trial, as seems likely, even as members of a class with reference to the second claim, they no doubt would desire to be included as intervenors with respect to the first claim as to which the statute of limitations defense does not appear so formidable.

Other practical considerations, unlike the situations in *Harris v. Jones, et al* and *Harris v. K.S.L.*, in which similar problems have been decided today, do not weigh in favor of a class action.

The purchasers of stock from the defendant corporation are not so numerous as to preclude intervention by those inteerested in the litigation. Most of them are residents of a relatively small community. This action has not been pending for any great length of time. It is unlikely that others

have refrained from individual action in reliance upon the designation in the complaint of the action as a class action. The court has not formally approved it as such. And even though persons have refrained for a limited period in taking individual action or intervening in reliance upon plaintiffs' designation, the delay likely will not have been prejudicial. If other stockholders have known of developments up to now suggesting a class action, no doubt they will shortly learn of this ruling; and if they have not known of the pendency of this action, they will not have been misled either by its being brought or by this recognition of it as an individual action only. The pleadings indicate that unless there were a tolling of the statute by failure of discovery or concealment, the action probably is barred as against all members of the alleged class. If there has been lack of notice or effective concealment to toll the running of the statute at the time of the original complaint, it seems unlikely that the situation would have changed by now and there should remain adequate time for additional actions or intervention.

Accordingly, the motions of the defendants are granted and the case will proceed as a suit by the named plaintiffs and not as a class suit, with intervention to be freely allowed prior to the time of the final pre-trial conference, and thereafter and up until the time of the trial upon a showing of good cause and in the interest of justice, on the part of any members of the alleged class who desire to intervene either through counsel for the named plaintiffs or through other counsel whom the intervenors may elect to have represent them in this action.

Dated this 9th day of August, 1966.

A. Sherman Christensen
UNITED STATES DISTRICT JUDGE

APPENDIX "B"

UNITED STATES COURT OF APPEALS

TENTH CIRCUIT

JULY, 1968, TERM

LEE J. ESPLIN, K. C. WEAVER, LEO REEVE, ARTHUR BARLOCKER and DOYLE SAMPSON, *Appellants,* vs. LELAND (LEE) HIRSCHI and LAVERNE HIRSCHI, *Appellees.*	Number 9718
WILLIAM A. BARLOCKER, *Appellant,* vs. LELAND (LEE) HIRSCHI and LAVERNE HIRSCHI, *Appellees.*	Number 9719
LELAND (LEE) HIRSCHI and LAVERNE HIRSCHI, *Cross Appellants,* vs. LEE J. ESPLIN, K. C. WEAVER, LEO REEVE, ARTHUR BARLOCKER, DOYLE SAMPSON and WILLIAM A. BARLOCKER, *Cross Appellees.*	Number 9800

APPEAL FROM THE
UNITED STATES DISTRICT COURT
FOR THE DISTRICT OF UTAH
(District Court No. C-243-65)

Before PHILLIPS, HILL and HICKEY, United States Circuit Judges.

HILL, Circuit Judge.

This action was commenced by Leland and Laverne Hirschi, appellees and cross-appellants here, individually and as a class action, against B & E Securities, Inc., William A. Barlocker, Lee J. Esplin, K. C. Weaver, Leo Reeve, Arthur Barlocker and Doyle Sampson.[1] The complaint alleged (1) a violation of 10(b) of the Securities and [sic] Exchange Act of 1934, 15 U.S.C. § 78j; and Rule 10 (b)-5 [sic] promulgated thereunder, 17 C.F.R. § 240.10b-5, and (2) a violation of the Investment Company Act of 1940, 15 U.S.C. § 80a-1, et seq.

Early in the litigation the trial judge determined the case was not a class action under Rule 23, F. R. Civ. P., as Amended, and dismissed that part of the complaint pertaining thereto.[2] The case proceeded to trial with the Hirschis as individuals and was submitted to a jury upon special interrogatories pursuant to Rule 49(a), F. R. Civ. P. Based upon the answers of the jury to the submitted interrogatories the trial judge found all of the defendants guilty of the alleged violation of the Securities Exchange Act of 1934 and liable in damages to the Hirschis in the amount of $15,600. The defendants were also found to have violated the Investment Company Act of 1940 but the court determined that the cause of action under the Act was barred by the statute of limitations.

In addition to the appeal by the individual defendants from the part of the judgment awarding damages, the Hirschis have cross-appealed from the dismissal of the class action and the denial of their cause of action under the Investment Company Act.

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[1]B & E Securities, Inc., is not a party to this appeal but all of the originally named individual defendants are appellants and cross-appellees.

[2]Hirschi v. B & E Securities, Inc., 41 F.R.D. 64 (D. Utah 1966).

The defendant, B & E Securities, Inc., is a Utah corporation formed early in 1961 for the original purpose of receiving and holding certain assets owned by the Bank of St. George, the disposal of which had been directed by the bank examiners. The incorporators and original directors of B & E were defendants, William A. Barlocker, Lee Esplin, K. C. Weaver, Leo Reeve and Arthur Barlocker. William Barlocker originally and at all times owned over fifty per cent of the voting stock of B & E. The defendant, Doyle Sampson, was an employee and agent of B & E.

Early in the life of the corporation it was determined that the purposes of the corporation should be expanded to include investment in certain real estate, insurance companies, and a motel corporation. To achieve these expanded purposes the Board of Directors undertook to sell stock in B & E to the public. Accordingly, steps were taken to provide for five hundred thousand shares of common stock, one hundred thousand shares of Class A preferred stock, three hundred thousand shares of Class B preferred stock and one million shares of Class C preferred stock. All the stock was to have a par value of $1.00 per share.

Sometime during September and again in November of 1961, the plaintiffs, Hirschis, were approached by defendant Sampson who told them among other things, that the investment potential of B & E was good and solicited their investment in the capital stock of the company. Pursuant to this solicitation the Hirschis purchased shares of stock in B & E to the extent of $20,800.00.[3] The Hirschis received a

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[3]The Hirschis purchased shares of stock in B & E as follows:

Date	No. of Shares	Class	Consideration
9-27-61	10,000	A Preferred	$10,000
11-30-61	10,000	B Preferred	$10,000
11-30-61	800	Common	$ 800

total of $2,500.00 in dividends on this stock; $500.00 in 1961, $1,000.00 in 1962, and $1,000.00 in 1963. B & E, Inc., was apparently at no time a profitable corporation and its assets became quite heavily encumbered.

In this action filed on December 2, 1965, it was asserted that defendants had violated section 10(b) of the Securities Exchange Act by employing devices, schemes and artifices in selling shares of stock to plaintiffs. It was undisputed that defendants did not deliver a prospectus to any of the investors and that the only written communications received by plaintiffs from the defendants were a letter dated October 24, 1962, giving notice of a special stockholders meeting for the purpose of a stock exchange, an official notice of the special stockholders meeting, a notice of the January 25, 1963, annual stockholders meeting dated December 21, 1962, a letter of October 1, 1963, concerning the reporting of dividends to the Internal Revenue Service and a statement of financial operations and retained earning of B & E Securities, Inc., for the fiscal year ending June 30, 1963.

It was admitted that it was not disclosed to plaintiffs the rights, privileges and preferences of the various classes of securities nor the manner in which the funds or assets of the corporation would be applied if the funds obtained from the issuance of stock were insufficient or the corporation was otherwise unable to engage in its proposed business activities. It was further admitted that neither B & E nor any securities issued by B & E were registered under the provisions of the Investment Company Act of 1940, that the defendant B & E, Inc., never complied with any of the statutory requirements of the Investment Company Act of 1940 and that the sales of the capital stock of B & E, Inc., were never registered with the Securities and Exchange Commission pursuant to the Securities Act of 1933, as amended.

It was specifically found by the jury in answer to special interrogatories submitted to them that the defendant B & E Securities, Inc., in connection with the sale of securities to plaintiffs made untrue statements of fact and omitted to state facts necessary in order to make the statements made, in light of the circumstances under which they were made, not misleading and that such misrepresentations or omissions were material.[4]

The jury further found with respect to plaintiffs' allegations that defendants' actions had concealed the fraudulent omissions and that plaintiffs had been lulled into not presenting an action based on these omissions earlier. The jury held that during the shareholders meeting of January 25, 1963, the plaintiffs first knew, or in the exercise of reasonable diligence and inquiry should have known, about the facts constituting such misrepresentations or omissions and that the plaintiffs should have known on or about May 7, 1962, that B & E Securities, Inc., engaged or proposed to engage primarily in the business of investing, reinvesting and trading in securities.

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[4]In addition, the jury found: (1) that B & E Securities, Inc., had knowledge that such statements were untrue or that there were such omissions and that such misrepresentations were intentionally made with knowledge on the part of B & E Securities, Inc.; (2) that plaintiffs would rely upon them in making stock purchases; (3) that William A. Barlocker, L. J. Esplin and K. C. Weaver were controlling persons at the time plaintiffs purchased their shares of stock of B & E Securities within the meaning of the Securities Exchange Act; (4) that Leo Reeve, Arthur Barlocker and Doyle Sampson were not such controlling persons; (5) that William Barlocker, Lee Esplin, Arthur Barlocker, Leo Reeves, Doyle Sampson and K. C. Weaver knowingly made or aided or abetted in the making of such material misrepresentations or omissions which were substantial factors in the decision of the plaintiffs to purchase such securities; (6) that B & E Securities engaged or proposed to engage primarily in the business of investing, reinvesting or trading in securities at some time from the organization to the time of sale of such securities to plaintiffs; and (7) that William Barlocker at the time of the sale of such securities to plaintiffs was a controlling person with respect to the activitie sof B & E Securities, Inc., within the meaning of the Investment Company Act of 1940.

Based upon these findings the trial court determined as a matter of law that plaintiffs were entitled to a judgment against the defendants on their first count but were barred by the statute of limitations from recovering under the second count. The various claims of the parties on appeal raise three basic issues: (1) whether the lower court was correct in dismissing the class action; (2) whether the cause of action based upon the Investment Company Act should have been held to be barred, and (3) whether the trial court applied the correct rule as to the measure of damages to be applied in 10b-5 actions.

This case presents the first occasion for this court to consider the scope of revised Rule 23 of the Federal Rules of Civil Procedure. Rule 23, as Amended, became effective July 1, 1966, and this action was filed in December, 1965. However, the decision on the question of allowing the class action was not made until August, 1966. As a result, the lower court considered it within its discretion to apply either the old or new rule. Inasmuch as the amendment of Rule 23 was intended primarily as a simplification and clarification of the prior rule and because the trial court did consider the new rule, we will review this decision solely on the basis of the rule as amended.[5]

Rule 23(a) and (b) delineate the factors to be considered in determining the propriety of a class action. The trial court considered, and the parties agree, that the four prerequisites found in Rule 23(a) were present in the instant case. Subdivision (b) establishes three further criteria and requires that

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[5]In the discretion of the court the amended rule can be applied to actions pending when it becomes effective. 2 Barron and Holtzoff, Federal Practice and Procedu § 562 p. 86 (1967 Supp.) citing: Harris v. Jones, 41 F.R.D. 70, (D. Utah 1966); Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673, 683 (N. D. Ind. 1966); and Booth v. General Dynamics Corp., 264 F. Supp. 465, 471 (N. D. Ill. 1967).

one of these be fulfilled before a class action is maintainable. The controversy to be resolved here is whether the provisions of 23(b)(3) were met.[6]

Before a class action can be established under (b)(3) it is necessary to find, first, "that the questions of law or fact common to the members of the class predominate over any question affecting only individual members," and second, "that a class action is superior to other available methods for the fair and efficient adjudication of the controversy."[7]

The lower court found, that as to the 10b-5 count, the individual questions involving the dissimilarity of oral representations, the issue of reliance and the matter of knowledge sufficient to invoke the statute of limitations, were the primary issues presented.[8] Consequently the court was of the

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[6]The lower court did not expressly ascertain the applicability of (b)(1) and (b)(2). Plaintiffs suggest that the action should be remanded to the trial court for specific determinations on those grounds. However, plaintiffs made no suggestion as to how this factual setting could be found to relate to those subsections, hence the district court was justified in not expressly considering them in its memorandum decision.

[7]In arriving at these determinations the court is directed to weigh four non-exhaustive factors: the interest of the class members in individually controlling separate suits, the extent and nature of litigation already pending, the desirability of concentrating litigation in a particular forum, and the difficulties likely to be encountered in managing a class action. F. R. Civ. P. 23(b)(3)(A), (B), (C) and (D).

[8]The court stated:

"There are some common issues of fact and law involved in this action. On the other hand it appears that there are questions of law and fact affecting the individual members of the class which could not be common to all the members of the class. For example: Whether the individual members relied upon specific or any oral representation made to them and not to members of the class in general; whether there was reliance upon representation made to others, and whether the particular member had knowledge or notice of the alleged causes of action early enough to be barred by the statute of limitations. These, I apprehend, may become primary issues in the case." Hirschi v. B & E Securities, Inc., 41 F.R.D. 64, 67 (D. Utah 1966).

opinion that the common questions did not predominate. "If there could be thought some question about this, the difficulties likely to be encountered in the management of the class action in this case, and the relatively limited benefits, if any, such an action could accomplish at greatly increased burden, have persuaded me to exercise whatever discretion I possess in proceeding otherwise."[9] The trial Judge further stated that "the purchasers of stock from the defendant corporation are not so numerous as to preclude intervention by those interested in the litigation,"[10] indicating that in his opinion the procedural technique of intervention would be superior to a class action in the present case.

We are thus faced with the question of whether the trial court was too restrictive in its interpretation of Rule 23 in not allowing this class action to proceed. Undoubtedly the possibility exists that there will be questions of individual oral misrepresentation to each of the potenteial plaintiffs relating to their inducement in buying the securities and in lulling them sufficiently to toll the statute of limitations. On the other hand, an examination of the Second Amended Complaint filed by the plaintiffs shows that the real basis of their allegations concerns the failure of the defendants to make any representations concerning relevant and material facts, i.e., certain omissions of material facts common to all purchasers. Clearly all of the purchasers received "dividends" from the defendant corporation which in connection with the minutes from the stockholders meetings and notices and letters sent to all shareholders were the primary considerations in determining whether the statute of limitations had been tolled. Finally, the issue in any 10b-5 action, upon which all others depend, is the existence of fraudulent and manipulative con-

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[9] 41 F.R.D. at 68.

[10] 41 F.R.D. at 69.

duct relating to the sale of the securities. Having alleged that there was no attempt to comply with the registration or periodic reporting provisions of the Securities Exchange Act, that there were omissions and half truths common to all purchasers, and that, as to all shareholders, there had been common letters and reports, it is apparent that the issue of liability — disregarding the defense of limitations — was to be the same as to all purchasers.

As to the Investment Company Act the lower court acknowledged that the claims of each and every member of the class were identical. Inasmuch as plaintiffs were merely requird to show that B & E was an investment company, that it had not registered and that the individual defendants were controlling persons, the activities of the plaintiffs could have little or no effect upon the operative facts determining liability. Hence, while the propriety of allowing a class action on the 10b-5 count is an extremely close question, there is really little doubt, as to the Investment Company Act, that the common issues predominate. Consequently, there does exist as to the totality of issues a common nucleus of operative facts such as would justify allowing the class action to proceed under newly amended Rule 23. It cannot be denied that the resolution of the class action issue in suits of this type places an onerous burden on the trial court. But if there is to be an error made, let it be in favor and not against the maintenance of the class action, for it is always subject to modification should later developments during the course of the trial so require. *Eisen v. Carlisle & Jacquelin,* 391 F.2d 555, 566 (2d Cir. 1968).

It is no doubt true that in determining the predominance of common over individual questions, the critical test is "whether there is 'material variation' in elements like the

representations made by the defendants to different members of a plaintiff class or the degrees of reliance by members of the class."[11] Accordingly, defendants stress the fact that there were oral misrepresentations that varied with respect to each of the purchasers. It is urged that this factor is exactly what was referred to by the Advisory Committee when it declared that "a fraud perpetrated on numerous persons by the use of similar misrepresentations may be an appealing situation for a class action, and it may remain so despite the need, if liability is found, for separate determination of damages. . . . On the other hand, although having some common core, a fraud case may be unsuited for treatment as a class action if there was material variation in the representations made or in the kinds of degrees of reliance by the persons to whom they were addressed." 39 F.R.D. 103. This has no applicability as to the Investment Company Act because the existence of oral misrepresentations is of no consequence. As to the 10b-5 action, the statement is relevant but not controlling. This is because the plaintiffs were not relying merely upon oral misrepresentations whose content would vary as to the class members, but rather, as later established at the trial, the investors did not rely upon oral misrepresentations at all, or for that matter upon any affirmative misrepresentations, but upon a complete failure to discolse any material facts — which default was necessarily common to all shareholders.[12]

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[11]Bromberg, Securities Law: Fraud — SEC Rule 10b-5 § 11.6 p. 257 (1968).

[12]In support of the lower court opinion it should be noted that a significant part of the transactions between defendants and plaintiffs were the statements made to plaintiffs before they purchased their stock. However, such statements would apply in general to all buyers who were the victims of the same omissions. The fact that one or more members of the class may have received additional affirmative misrepresentations would be merely cumulative inasmuch as the omissions alone were sufficient to establish deceptive practices. In sum, it was alleged and later proved that the omissions which were the operative facts relied upon to show fraud were the same as to all investors.

There have been a number of cases considering the effect of newly amended Rule 23.[13] In *Kronenberg v. Hotel Governor Clinton, Inc.*, 41 F.R.D. 42 (S.D.N.Y. 1966), it was recognized that although oral misrepresentations might make a class action more difficult it still could be maintained. "While there may be different kinds of misrepresentations alleged with respect to different plaintiffs, including some oral misrepresentations, and while such factors might have led to a dismissal of the class action under the old rule [citations omitted] the new Rule 23 provides the flexibility to permit this action to proceed." *Id.* at 45. Thus, the new rule is designed to expand the situations in which a class action is appropriate. However, even under the old rule it was held that the potential dissimilarity of misrepresentations would not prohibit a class action when the omissions relied upon, in addition to affirmative misrepresentations, established a common course of conduct. *Harris v. Palm Springs Alpine Estates, Inc.*, 329 F.2d 909, 914 (9th Cir. 1964).

In *Harris* it was asserted that because the investors made payments on the securities at different times and stood in different positions with respect to the representations made to them and the reasonableness of their reliance, the common issues did not predominate. The court answered: "But even assuming these premises to be true, since the complaint alleges a common course of conduct over the entire period, directed against all investors, generally relied upon, and violating common statutory provisions, it sufficiently appears that the questions common to all investors will be relatively substantial." *Id.* at 914.

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[13]E.g., Eisen v. Carlisle & Jacquelin, supra; Moscarelli v. Stamm, 37 U. S. L. Week 2066 (E. D .N. Y. 1968); Brennan v. Midwestern United Life Ins. Co., 259 F. Supp. 673 (N.D. Ind. 1966); Fischer v. Kletz, 41 F.R.D. 377 (S. D. N. Y. 1966); Harris v. Jones, 41 F.R.D. 70 (D. Utah 1966).

In *Dolgow v. Anderson*, 43 F.R.D. 472 (E.D.N.Y. 1968), Weinstein, J., in an extensive opinion dealing with the effect of the amendments of Rule 23, declared that: "Unpersuasive is defendants' reliance upon the fact that there are involved a plethora of statements not all of which were necessarily brought to the attention of all investors." *Id.* at 489. In addition, it was stated that "[D]efendants argue that each member of the class would have to prove reliance, compliance with the statute of limitations, and damages, and thus the common questions cannot be said to predominate over those affecting individual members. . . . The common issues need not be dispositive of the entire litigation. The fact that questions peculiar to each individual may remain after the common questions have been resolved does not dictate the conclusion that a class action is not permissible." *Id.* at 490.

We hold, therefore, that the common questions presented, both by the 10b-5 and Investment Company Act issues, were sufficiently predominate to satisfy the first prerequisite for a 23(b)(3) type of class action.

The remaining consideration in determining the propriety of the class action is whether it is superior to other available procedural devices. The lower court indicated that efficiency could best be served in the instant case by allowing intervention. However, the procedures available for handling proliferated litigation, including intervention, presuppose "a group of economically powerful parties who are obviously able and willing to take care of their own interests individually. . . ." Frankel, Amended Rule 23 from a Judge's Point of View, 32 Antitrust L. J. 295, 298 (1966). Yet if the purchasers fit this description, it is to be supposed that the defendants would join in demanding a class action since they could scarcely desire to defend separate actions by each party they have

now admittedly injured. Hence, there can be little doubt that this action on behalf of more than 200 defrauded securities purchasers presents a particularly appropriate situation for a class action. To resolve in one suit the common questions of liability under the Exchange Act — the existence and materiality of fraudulent conduct — and the Investment Company Act — the existence of an unregistered investment company — and the status of alleged controlling persons under both acts, eliminates the need for each injured investor to attempt to separately prove these basic allegations. "Thus, it is virtually certain that a class action will 'achieve economies of time, effort, and expense, and promote uniformity of decision as to persons similarly situation.' " *Dolgow v. Anderson*, supra at 488.

In sum, it is entirely understandable why the lower court, considering merely the abstract question of whether common issues predominate, decided as it did. But taking the issue in the context of the securities laws and realizing that "the ultimate effectiveness of the federal remedies . . . may depend in large measure on the applicability of the class action," 3 Loss, Securities Regulation 1819 (2d. ed. 1961), the interests of justice require that in a doubtful case, such as was presented here when considered by the trial court, any error, if there is to be one, should be committed in favor of allowing the class action. In the usual case when the class action is being considered prior to trial, it is within the power of the court to limit either the issues or the parties. The same remains true here. If it develops as to some of the investors that they had superior knowledge or received unique representations or that they were in some way atypical, then the subclass authorization of Rule 23, or some other procedural

device can be fashioned to meet the exigencies of the situation.[14]

We turn now to the issues presented by the lower court's barring the cause of action under the Investment Company Act of 1940. The jury in answering a special interrogatory found that, considering all the pertinent circumstances, including the payment of dividends, and any other lulling or concealing activity on the part of the defendants, the plaintiffs knew or should have known on May 7, 1962, that B & E Securities, Inc., was engaged or proposed to engage primarily as an investment company as defined by the Act. Because the Investment Company Act does not contain an applicable statute of limitations certain state statutes were applied to determine whether the cause of action was barred. In so doing, the trial court correctly determined that it must look to the statutes of the forum state.[15]

Section 78-12-27 of the Utah Code Annotated was applied to the individual defendants. This section provides for a three year limitation period for relief based upon a statutory

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[14]In holding that the class action should have been allowed, it becomes necessary to comment briefly on the effect of this upon the statute of limitations issue. This court has held that the commencement of a spurious class action halts the running of the statute as against all members of the class. Union Carbide and Carbon Corp. v. Nisley, 300 F.2d 561, 590 (10th Cir. 1962). The same will be true under newly amended Rule 23. Hence, the rights of all class members are to be determined as if the class action had been allowed instead of being incorrectly terminated below. This means that the status of class members is to be determined by relation back to the date of the initiation of this suit in December, 1965.

[15]There are a substantial number of decisions considering the question of which statute to apply to actions based upon § 10(b) and Rule 10b-5 of the Exchange Act. See Chiodo v. General Waterworks Corp., 380 F.2d 860 (10th Cir. 1967); Janigan v. Taylor, 344 F.2d 781 (1st Cir. 1965). The parties are agreed, and this court is persuaded, that the reason for applying the forum state statute in 10b-5 actions applies as well to implied private actions under the Investment Company Act of 1940.

violation by the directors of a corporation.[16] Because this action was instituted more than three years after May 7, 1962, the action was declared to be barred.

Plaintiffs contend that the trial court should have applied section 78-12-23 which declares that an action based upon a written contract may be instituted any time within six years. However, in seeking to establish that the security purchase agreement was founded upon a written obligation the plaintiffs are forced to rely upon a personal check, a promissory note and stock certificates as the only written indicia of the agreement. It thus becomes apparent that the action is not founded upon a written instrument.[17]

It is further contended that it is established Utah law that when there is some doubt as to the statute of limitations to be applied the court should apply the statute which permits the action to proceed. Nonetheless, in characterizing the action under the Investment Company Act for purposes of determining the most appropriate state statute, it cannot be gainsaid that the gist of the action is not the breach of a written contract. Inasmuch as this is the relevant inquiry in determining which statute to apply, it follows that the decision by the lower court to apply the three-year statute relating to statutorily imposed liability is exceedingly more appropriate. The action is grounded in the failure to meet the

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[16]"Actions against directors or stockholders of a corporation to recover a penalty or forfeiture imposed, or to enforce a liability created, by law must be brought within three years after the discovery, by the aggrieved party, of the facts upon which the penalty or forfeiture attached, or the liability accrued. . . ." Utah Code Annot., § 78-12-27 (1953).

[17]The Utah Supreme Court analyzed the applicability of the six year statute, holding that in order to be applicable the action must be founded upon a written instrument, i.e., "when the contract, obligation, or liability grows out of written instruments (emphasis by the court) not remotely or ultimately, but immediately." (Emphasis supplied). Bracklein v. Realty Ins. Co., et al., 80 P.2d 471, 476 (Utah 1938).

requirements of the Investment Company Act. It is difficult to conceive of a statute of limitations that could be more compatible in this context.

The trial court held that as to the defendant corporation the action was likewise barred. The court applied section 78-12-25 (2), Utah Code Annot., which provides that an action may be instituted within four years for any action not otherwise governed by any of the other more specific limitation sections. Applying this catchall section and the appropriate date of May 7, 1962, it is difficult to understand why the action was held to be barred. The four year period of limitation would not have elapsed until May 7, 1966; yet the action was admittedly instituted in December, 1965. Plaintiffs urge on appeal that this error can be explained only as a result of the fact that the lower court failed to apply the federal tolling policy. If that were the situation, then the applicable dates would be September and November, 1961, the dates of the purchase of the securities. If this had been the court's approach then it undoubtedly would have precluded the issue in the pretrial order or in some fashion have indicated the reason for the divergent treatment of the defendant corporation and the individual defendants. Yet nowhere in the record is there any enlightening explanation.[18]

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[18]It is conceivable that the lower court merely applied the statutes as framed by the state. The statute applied to the 10b-5 count and that applied to the individual defendants under the Investment Company Act, both contained within the statute a provision incorporating tolling until the discovery of the operative facts by the plaintiff. The statute applied to the defendant corporation does not contain such an express provision. However, if this were indeed the theory below, it was error. In Janigan v. Taylor, 344 F.2d 781 (1st Cir. 1965), the court read the tolling provision into the Massachusetts statute, concluding that it is a matter of federal law as to the circumstances that will toll the statute. "Although Massachusetts law apparently requires active concealment in order to toll a statute of limitations re fraud, the Court applied the federal tolling approach which is characterized as one under which fraud is viewed as automatic concealment until discovery." Bloomenthal, Securities Law 464 (1966).

In any event, the federal law clearly requires that in every limitation question the old chancery doctrine of equitable tolling is to be applied. In *Holmberg v. Armbrecht*, 327 U.S. 392, 397 (1946), the Supreme Court announced the proposition that "where a plaintiff has been injured by fraud and 'remains in ignorance of it without any fault or want of diligence or care on his part, the bar of the statute does not begin to run until the fraud is discovered. . . .'" This federal policy of tolling has consistently been applied to actions brought under section 10(b) of the Exchange Act;[19] it has been applied to actions under section 16(b) of the Exchange Act, *Grossman v. Young*, 72 F. Supp. 375 (D.N.Y. 1947); and this court has sanctioned its application to the Clayton Act, *Public Service Co. of New Mexico, et al v. General Electric Co.*, 315 F.2d 306 (10th Cir. 1963). Thus, as indicated in *Janigan v. Taylor*, supra, it is a matter of federal law as to the circumstances that will toll a state statute applied to private actions under the securities laws. Accordingly, applying the four year period of limitation, the federal policy of tolling, and the appropriate date as found by the jury of May 7, 1962, it appears that the action against B & E was not barred.

The defendants have indicated that the jurisdiction of the court was challenged in regard to the private action based upon the Investment Company Act. They did not find it necessary to discuss the problem in any detail. As a result, it becomes necessary for this court to consider the issue on its own motion.

In view of the recent developments of the law in implying private civil remedies for violations of the various federal securities laws, the strong indication is that when given

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[19]See Bloomenthal, supra at 463.

the opportunity, the Supreme Court following the policy announced in *J. I. Case Co. v. Borak*, 377 U.S. 426 (1964), will find an implied civil liability arising from the Investment Company Act thereby superseding the only authority to the contrary, *Brouk v. Managed Funds*, 286 F.2d 901 (8th Cir. 1961). Brouk was implicitly overruled by *Greater Iowa Corp. v. McLendon*, 378 F.2d 783 (8th Cir. 1967), in which the court indicated that the other Circuits passing on the question had upheld a private cause of action. This court, therefore, finds that although the Investment Company Act makes no specific provision for private civil liability arising from the violations of the Act such liability may be implied.

The court below in its conclusions of law found that B & E was at all times after July 1, 1961, an unlicensed investment company within the definition, meaning and intent of the Act. Hence, the cause of action against B & E should have been sustained and the requested rescission of the security purchase arrangement allowed.[20] This conforms with the provisions of the Act declaring any contracts made by an investment company in violation of the Act (including the sale of unregistered securities) to be void.[21]

Lastly, defendants contend that as to the 10b-5 action the lower court committed error in awarding damages to the plaintiffs in the amount of $15,600.00. The issue of damages was submitted below upon a specal interrogatory requesting the jury to ascertain the value of the purchased securities at three pertinent dates, i.e., the date of purchase, the date the suit was instituted and the date of the trial. The

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[20]Obviously, cross-appellants will not be entitled to recover under both Rule 10b-5 and the Investment Company Act. The entire discussion of the latter point was made necessary because of the further proceedings to be had in the case as a class action.

[21]15 U.S.C. § 80a-7(b) and 80a-46(b) (1965).

jury found that the securities were worthless on the latter two dates but determined that as of the date of purchase the preferred shares had a value equal to the purchase price. The common stock was valued at $.60 per share. On the basis of these findings plaintiffs' damages would be limited to $320.00.

The lower court, however, disregarded the jury finding choosing rather to fix the relevant date for determining the loss as of the date of the plaintiffs' discovery of the fraud. Inasmuch as the jury had not been requested to fix the value on this latter date, the court exercised its reserved power under Fed. R. Civ. P. 49 and found that "on January 25, 1963, when plaintiffs were charged with notice of said defendants fraud this stock had a reasonable and actual value of less than 25 cents per share." The plaintiffs were thus allowed a recovery of $15,600.00.[22]

The defendants contend that the proper measure of damages is the difference between the amount plaintiffs paid for their stock in 1961 and its actual value at that time. As support for this position defendants cite *Estate Counseling Service, Inc. v. Merrill, Lynch, Pierce, Fenner and Smith, Inc.*, 303 F.2d 527 (10th Cir. 1962). In that case this court was concerned with the distinction between "benefit of the bargain" and "out of pocket" damages. In adopting the latter view, the specific question of the appropriate date for ascertaining such damages was not before the court. Our statement that "the question is not what the plaintiff might have gained, but what he has lost by being deceived into the purchase," does, however, point to the crux of the issue here presented.

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[22]The $15,600 in damages was arrived at by subtracting $5200 ($.25 x 20,800) from the purchase price of $20,800.

The plaintiffs have incurred a loss as a result of the fradulent practices of the defendants in the sale of securities in violation of the securities laws. The extent of this loss will not necessarily be fully known until some time after the original transaction. This follows because the same fraudulent practices that have induced the plaintiffs' purchase of the securities also operate on other buyers thereby affecting the prevailing market price. It is not until the existence of the fraudulent conduct is known that the true value of the securities as an investment can be ascertained.[23] Accordingly, where the purchaser acquires the securities for investment purposes, and thus intends to retain them for a reasonable period of time, the actual extent of the loss sustained may be ascertained as of the date the purchaser realizes, or should realize, that he has been defrauded. It is at this date, when the purchaser discovers the fraud, that he is first in a position to seek redress either through a recission of the contract, or in an action for damages.[24]

We hold, therefore, under the facts and circumstances of this case that the appropriate date to be applied in determining damages is the date on which the fraud was, or in the exercise of reasonable diligence should have been, discovered. Thus the defrauded buyer is entitled to recover the difference between the price paid for the securities with interest from the date of purchase, and the value of the securities determined as of the time of the discovery of the fraud. In addition, the buyer is entitled to recover any additional outlays attributable to the defendants conduct less dividends or any other payments received from the defendant seller. The damages awarded below do not specifically conform to this

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[23]Loss, Securities Regulation 1630 (2d ed. 1961).

[24]See, Restatement of Torts § 549, Comment c; and Loss, supra, at 1630 and 1793.

formula. However, the plaintiffs having failed to raise the issue, the amount of damages must remain undisturbed.

The money judgment in favor of appellees and against appellants is AFFIRMED and the case is REMANDED for further proceedings in accordance herewith.